PUBLIC BRIEFING
ON THE
COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR) FOR
FISCAL YEAR 2011

Before the
Committee of the Whole
Council of the District of Columbia

The Honorable Kwame R. Brown, Chairman

February 6, 2012, 11:00 a.m.
Council Chambers, Room 500

Testimony of
Natwar M. Gandhi
Chief Financial Officer
Government of the District of Columbia

Good morning, Chairman Brown and members of the Committee of the Whole. I am Natwar M. Gandhi, Chief Financial Officer of the District of Columbia Government. With me today is Deputy Chief Financial Officer Anthony Pompa of the Office of Financial Operations and Systems. Also present are Deputy Chief Financial Officers Lasana Mack of the Office of Finance and Treasury, Fitzroy Lee of the Office of Revenue Analysis, Gordon McDonald of the Office of Budget and Planning, and Stephen Cordi of the Office of Tax and Revenue.

We are here today to report and discuss the Fiscal Year 2011 Comprehensive Annual Financial Report (CAFR).

Introduction

Mr. Chairman, I am pleased to present the results of the District's Fiscal Year 2011. There has been a significant improvement in the overall financial position of the city. Our "rainy day" funds have increased by 58 percent in a single year, and we now have over a half a billion dollars in reserve and our fund balance has increased to $1.1 billion. This is the direct result of legislation passed in December 2010 to create the Fiscal Stabilization Reserve and Cash Flow Reserve accounts in the General fund balance. I commend our elected officials for the wisdom to take steps to ensure the District's long term fiscal stability.

This is particularly important this year when the federal government's own budget process could result in what is known as "sequestration", the effects of which could result in significantly lower levels of federal spending in the Washington metropolitan area. This is the reason Moody's Investors Service has placed the General Obligation bonds of the District, as well as Maryland and Virginia, on "negative" outlook.

Although again this year, the District faces substantial challenges in its budget, I have every confidence that the challenges will be met in a fiscally responsible manner, and that we will continue to produce balanced budgets. That said, it will not be easy. We have a large number of residents who are unemployed, some as a direct result of the national economic stress, and we continue to have a significant number of needy residents. Resources on which we previously relied, such as the federal fiscal stimulus funding, received in 2009 and 2010, and which provided much needed relief, are no longer available. Again, I firmly believe that the District can rise to these challenges.

CAFR Results

I am pleased to report that this year, for the 15th consecutive time, the District has received an unqualified, or "clean," audit opinion on its annual financial statements. The CAFR shows that, for the year ending September 30, 2011, the

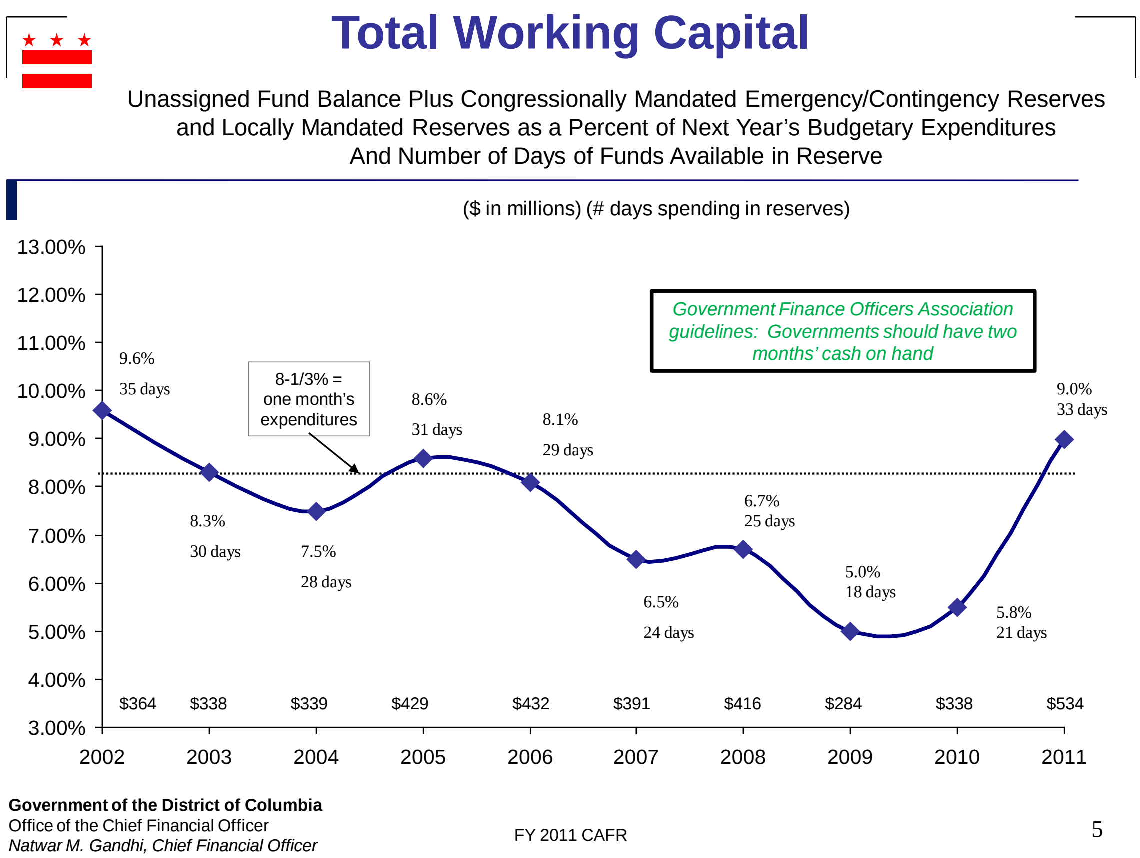
District’s revenues combined with other sources exceeded expenditures by $240 million, or 4.0 percent of expenditures, on a budgetary basis. (See Appendix 3) Of that amount, $166 million, or 2.9 percent of local expenditures, was attributable to Local sources. This budgetary surplus is reflected in the General Fund balance, all of which is either reserved or designated for specific purposes (See Appendix 2). See the table below for detail of the composition of the FY 2011 Budgetary surplus.

COMPOSITION OF BUDGETARY SURPLUS, FY 2011

	Local Funds	O-Type	Total General Fund
Operating margin in revised budget	1	-	1
Higher/(lower) revenues, other than use of fund balance	73	65	138
Higher/Lower use of fund balance	6	(56)	(50)
Lower spending	87	64	151
Adjustment	-	-	1
Actual Operating margin	166	73	240
Note: Details may not add to totals due to rounding.			

The $240 million is not available to spend on new programs or tax reductions. In accordance with law, the available surplus was deposited in the two new accounts created in the Sustainable Capital Investment and Fund Balance Restoration Act of 2010 to begin to rebuild fund balance. The Act does not allow us to use these funds unless it meets the criteria set out for the Congressionally mandated Emergency and Contingency reserves. It is essential to rebuild our fund balance. When we met with the rating agencies last Friday, the very strong message from all three was that the possibility of federal cutbacks resulting from sequestration, should that occur, creates a high degree of uncertainty.

Therefore, it is imperative that we retain the funds currently in our fund balance. Last year, our fund balance had reached perilously low levels. The spendable funds on hand (working capital) would have kept the government going for only half a month. The Government Finance Officers Association (GFOA) standards now call for two full months as the best practice. Depleting fund balance was an unacceptable risk for the Nation's capital. We are pleased to say that we now have over one month of working capital on hand.



I must point out here that although $240 million is a very large dollar amount, it is a small percentage of the total budget. Indeed, the comparison below shows that, compared to the average of our triple-A rated neighbors, the District's FY 2011 results for both revenues and expenditures are more favorable, in terms of ending closer to the Revised Budget.

	REVENUES			
Government General Fund*	Final/Revised Budget	Actual	Budget vs Actual	% variance
Virginia	15,789,063	16,208,487	419,424	2.7%
Maryland	13,159,029	13,186,269	27,240	0.2%
Arlington	957,846	984,306	26,460	2.8%
Alexandria	525,156	548,303	23,147	4.4%
Fairfax	3,269,900	3,321,826	51,925	1.6%
Anne Arundel	1,168,270	1,167,002	(1,267)	-0.1%
Prince Georges	1,504,841	1,544,584	39,743	2.6%
Average variance				***2.0%***
District of Columbia	**6,218,114**	**6,306,206**	**88,092**	**1.4%**
DC Local Only	**5,737,298**	**5,816,046**	**78,748**	**1.4%**

	EXPENDITURES			
Government General Fund*	Final/Revised Budget	Actual	Budget vs Actual	% variance
Virginia	16,590,516	16,091,517	(498,999)	-3.0%
Maryland	13,366,154	13,256,795	(109,359)	-0.8%
Arlington	1,027,013	940,909	(86,104)	-8.4%
Alexandria	315,682	309,447	(6,235)	-2.0%
Fairfax	1,257,276	1,188,326	(68,951)	-5.5%
Anne Arundel	1,174,334	1,161,865	(12,468)	-1.1%
Prince Georges	1,418,024	1,408,935	(9,089)	-0.6%
Average variance				***-3.1%***
District of Columbia	**6,217,283**	**6,066,511**	**(150,772)**	**-2.4%**
DC Local Only	**5,736,467**	**5,649,812**	**(86,655)**	**-1.5%**

* Note: Montgomery County and Howard County are excluded from the analysis because latest available CAFR on web site is FY 2010.

When viewed from the local budget perspective, the end of year variances are equal or even smaller: Revenues varied by 78 million or 1.4 percent; Expenditures varied by 87 million or 1.5 percent.

As presented in the CAFR, at the end of fiscal year 2011, the cumulative General Fund balance was $1.1 billion, an increase of $215 million over fiscal year 2010. This increase represents a turnaround from the three previous fiscal years in which the fund balance declined. Currently, the District's General Fund balance position is better than that of most major municipal governments that have seen sometimes precipitous declines in revenues.

I must note here that the new locally mandated reserves are not available for appropriation in future budgets. The funds are there to use for true emergencies or for unforeseen events that may arise throughout the fiscal year, and for the improvement of the District's operating cash position.

The Independent Auditors' Report on Internal Control Over Financial Reporting (known as the Yellow Book report) which accompanies the CAFR, again this year shows no material weaknesses, and two significant deficiencies, down from five last year. We regard these problems as serious matters and the affected agencies are aware that they can call on the OCFO for advice and assistance in resolving the problems that led to the findings. See Appendix 5 for a history of Yellow Book findings.

Economy

The District's economy and its revenues began to show signs of recovery after the first quarter of fiscal year 2011 and in February 2011, for the first time since September 2008, the revenue estimate was increased slightly by $3.5 million compared to the previous estimate. The revenue estimate for FY 2011 was subsequently increased further in June and September by $107 million and $89 million, respectively. Throughout the year, I thoroughly briefed the Mayor and Council on the improving economy and increasing revenues.

Although the District's economic and fiscal prospects have improved over the past year, the uncertain nature of the current economic recovery will continue to affect the District's financial condition in future fiscal years. Over the past few months, forecasts for the District's economy have been similar to those for the US: weak growth, but no double-dip recession. The primary concern is the federal government's budget decisions. Federal government expansion cushioned the District and the metro area economies from the worst effects of the recession over the past 4 years.

There is no question that the Federal government is a key driver of the District's economy. Federal civilian employees account for about 29 percent of all wage and salary employment in the District, and 35 percent of the wages and salaries paid in the city. About 45,000 District residents, or about 15 percent of all employed DC residents, are employed by the federal government. In Fiscal Year 2010, the Federal government spent a total of $62 billion in the District in salaries and wages, procurement, grants, retirement and other benefits, and other direct payments. This represented about 60 percent of the District's gross state product, compared to 33 percent in Maryland and 32 percent in Virginia.

But federal cutbacks now pose a major risk to the District's revenue outlook. In addition to federal government cutbacks, the District faces other downside risks, including financial market shocks from the on-going Euro-zone debt crisis, the possibility of a slowing down or reversal of a still fragile economic recovery, possible disruptions to oil supplies in the Middle East, and given our status as the nation's capital, the ongoing threat of a national security event.

Near Term Outlook

The ability to effectively manage the District's finances depends on sound and reasonable revenue estimates. In December, my office released a new revenue certification showing an additional $42 million in FY 2012, but lower revenue for FY 2013 through FY 2015. The estimate for FY 2013 through FY 2015 was lowered mainly to account for the impact of current federal law requiring sequestration of federal expenditures beginning January 1, 2013.

SUMMARY OF DECEMBER 2011 FORECAST					
	Actual	Estimate		Projected	
Local Source, General Fund Revenue Estimate ($ millions)	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
September 2011 Forecast		**5,627.9**	**5,773.8**	**5,948.3**	**6,134.1**
Change from prior forecast		42.2	0.3	(6.0)	(36.3)
Change due to federal sequestration		-	(46.7)	(86.1)	(93.5)
Total Changes From September		***42.2***	***(46.4)***	***(92.1)***	***(129.8)***
December 2011 Revenue Estimate	**5,321.7**	**5,670.1**	**5,727.4**	**5,856.2**	**6,004.3**
Percent growth over previous year	*4.8%*	*6.5%*	*1.0%*	*2.2%*	*2.5%*

As you can see, the December estimate took into consideration the change due to federal sequestration. Later this month, we will release a new revenue estimate and a crucial element of that revenue estimate will be any new information on the planned federal cutbacks. Although the current revenue estimate includes the impact of federal sequestration on the District, the estimate is based on one particular scenario. If the federal cutbacks are more severe than the scenario assumes, the fiscal outlook would worsen. On the other hand, if the federal government adopts a budget with less severe cuts than assumed here, the District's fiscal outlook would improve.

Debt

The District has higher debt ratios than other states or large jurisdictions, partly because the District functions include that of a state, a city, a county and a school district. The high debt levels limit our ability to borrow more to finance additional infrastructure. I again commend the elected leadership for adopting the 12 percent limitation on debt. This prudent action, which was well received by the rating agencies, has served us well in this period of economic and fiscal challenges as there has been, and will continue to be, a great deal of pressure on the remaining 88 percent of the budget that is available for providing services to residents.

The District continued to enjoy strong ratings on both its general obligation and income tax bonds. The District's Income Tax Secured Revenue Bonds are currently rated as follows: AA+ by Fitch Ratings; Aa1 by Moody's Investors Service; and AAA by Standard and Poor's Rating Service. All three rating agencies have assigned “stable” outlooks to the District’s Income Tax bonds. The credit rating agencies have also rated the District’s general obligation bonds favorably with current ratings as follows: AA- (Fitch Ratings); Aa2 (Moody’s Investors Service); and A+ (Standard & Poor’s Rating Service). Although Fitch and S&P carry “stable” outlooks on the general obligation bonds, Moody’s revised its outlook on the District’s GO bonds to “negative”, citing the uncertainty surrounding federal spending and its potential effect on the District’s economy. We were not alone – both Maryland and Virginia, as well as a number of other state and local governments with a large federal presence, were also placed on negative outlook.

Maintaining strong bond ratings has never been more important as the District continues to be affected by the economic decline of recent years. Measures must be taken to avoid practices that will compromise the District’s bond ratings or present the risk of a downgrade in ratings; such actions would result in higher borrowing costs in the future. Accordingly, the District should make every effort to limit the use of reserves and other one-time sources to meet recurring operational needs or close budget gaps. The District must be prudent in its use of available financial resources.

Still, the District must attend to its infrastructure. In order to stay within the 12 percent debt service cap throughout the Capital Improvements Plan (CIP) period, planned borrowing was adjusted in the FY 2012 – FY 2017 CIP. Current planned borrowing levels keep us under the legislative mandate of 12 percent cap through FY 2017. We will work with the Mayor and Council in developing a revised Capital Improvement Plan for the FY 2013 Budget and Financial Plan in an effort to prioritize the most important projects and postpone those projects that can wait until our revenue forecast is more positive.

District of Columbia						
Summary of Debt Cap Position as of December 31, 2011						
($ in millions)						
	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
Total Debt Service on Existing & Planned Tax Supported Debt	$ 647.0	$ 704.5	$ 754.2	$ 778.0	$ 803.3	$ 829.4
General Fund Expenditures	$6,480.3	$6,546.8	$6,718.7	$6,868.5	$7,040.2	$7,216.2
Ratio of Debt Service to Expenditures	9.98%	10.76%	11.22%	11.33%	11.41%	11.49%

Financial Management Improvements – Yellow Book Report

The "Independent Auditors Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards," commonly called the "yellow book" report, listed no material weaknesses and two significant deficiencies for FY 2011. Significant deficiencies reflect problems in the design or operation of internal controls over financial reporting. The prior year (FY 2010), the District had no material weaknesses and five significant deficiencies, so we are showing clear signs of improvement.

We take these findings seriously, both in areas under direct control of the OCFO as well as in areas under the authority of the Executive. I am, of course, pleased that there are no significant deficiencies under the control of the OCFO this year. We will work with the appropriate agencies to improve internal controls in their areas, with the goal of eliminating all significant deficiencies.

CONCLUSION

In summary, despite the current challenges, I continue to believe the District has the ability to sustain all that it has accomplished in the past decade. In many respects, I see a brighter future. Our population is growing again. The 2011 increase of 13,084 was the biggest one year increase since 1946. (The only year that came close was the 13,000 gain in 1960.) Compared to all 50 states, DC had the highest population growth rate in 2011. The rate, 2.2%, was much higher than the next highest, Texas, at 1.7%, and the US average of 0.7%.

This financial report presents the results of the collaborative efforts of the Mayor, Council, Agency Directors, and others throughout the District to improve financial stability in fiscal year 2011. We have continued to function under the constraints of a limited tax base, which goes to the heart of our budgetary challenges. Due to the District's disciplined financial management practices, we have weathered the economic storm relatively well in comparison with many other jurisdictions.

I want to take this opportunity to thank the many District government employees, from both the financial and program areas, who have worked long and hard to ensure the successful closure of the District's books and the maintenance of the high-quality records required for an unqualified audit opinion. In particular, I commend Tony Pompa, the District's Controller, his deputy, Bill Slack, and the rest of the team at the Office of Financial Operations and Systems, for their hard work and dedication. I would also like to thank the Associate Chief Financial Officers: Cyril Byron, Mohamed Mohamed, George Dines, Deloras Shepherd, and Angelique Hayes, as well as the rest of my senior management team and their staff: Gordon McDonald, Lasana Mack, Fitzroy Lee, Stephen Cordi, John Ross, Bill Divello, and Kathy Crader for their contributions.

I also thank the public accounting firm of KPMG, who were assisted by Bert Smith and Company, for their efforts throughout the audit engagement. Their highly professional staffs worked equally long and hard during the past few months to successfully complete this audit. In particular, I commend Jack Reagan, Chuck Kozlik and Abdool Akhran for their efforts.

Thanks also go to Inspector General Charles Willoughby and to Ron King, the chair of the CAFR oversight committee. Their independent oversight is critical to the integrity of this process.

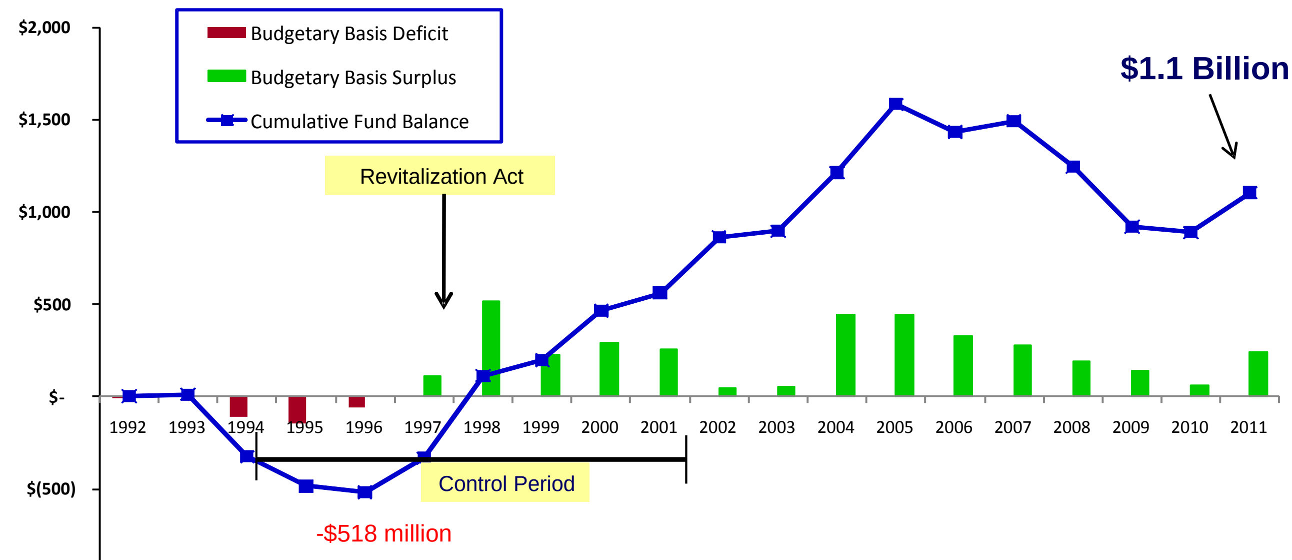
Let me also extend my deepest thanks to all who helped make this possible, several of whom were a part of the process in different capacities, including the Mayor, and you, Chairman Brown, as well as City Administrator Allen Lew. Also thanks go to Mr. Evans and the rest of the Council for their guidance, support and oversight of the process. Their leadership and commitment to fiscal prudence was an essential part of this successful endeavor.

Mr. Chairman, this concludes my remarks. I would be pleased to answer any questions you may have.

Appendix 1

District of Columbia

District of Columbia
Surplus and Bond Rating History



General Obligation Bond Ratings

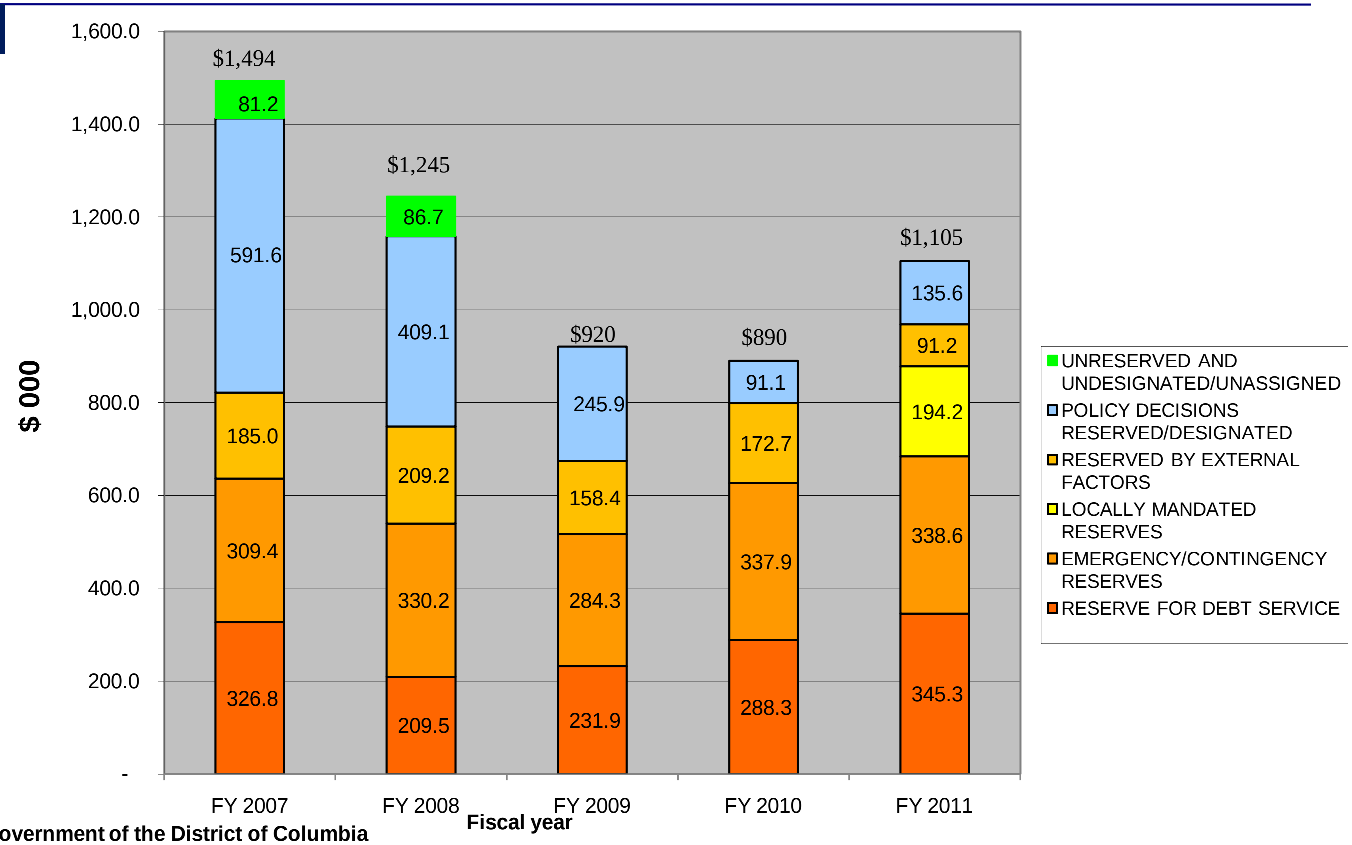
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
S&P:	A-	A-	A-	BBB-	B	B	BB	BBB	BBB	BBB+	BBB+	A-	A	A+	A+	A+	A+	A+	A+	A+
Moody's:	Baa	Baa	Baa	Ba	Ba	Ba2	Ba1	Ba1	Baa3	Baa3	Baa1	Baa1	A2	A2	A2	A1	A1	Aa2	Aa2	Aa2
Fitch:		A-	BBB+	BB	BB	BB	BB+	BB+	BBB	BBB	BBB+	A-	A-	A	A	A+	A+	AA-	AA-	AA-

Income Tax Secured Revenue Bonds: S&P: AAA Moody's: Aa1 Fitch: AA+

Composition of General Fund Balance

FY 2007 – FY 2011

($ in millions)



Appendix 3

Summary of Revenues, Expenditures and Surplus
Total General Fund

FY 2011 TOTAL GENERAL FUND								
					Actual vs. Revised		Actual vs. Original	
	Original	Revised	Actual		$	Percent	$	Percent
Revenues:								
Taxes	$ 4,870	$ 5,054	$ 5,203		149	2.9%	333	6.8%
Non Taxes	$ 874	$ 812	$ 906		94	11.6%	32	3.7%
Fund balance release	$ 115	$ 106	$ 56		(50)	-47.1%	(59)	-51.3%
All other GF Sources	$ 258	$ 247	$ 141		(105)	-42.7%	(117)	-45.2%
Total Revenues	$ 6,116	$ 6,218	$ 6,306		88	1.4%	190	3.1%
Less Fund Balance release	**$ 6,001**	**$ 6,113**	**$ 6,250**		**138**	2.3%	**249**	4.1%
Expenditures:								
FY 2011 Advance to Public Education	$ 6,115	$ 6,091	$ 5,940		(151)	-2.5%	(175)	-2.9%
FY 2012 Advance to Public Education	$ -	$ 127	$ 127		-	0.0%	127	
Total Expenditures	$ 6,115	$ 6,217	$ 6,067		(151)	-2.4%	(48)	-0.8%
Revenues vs. Exp	**$ 1**	**$ 1**	$ 240		**239**		**238**	
Surplus as % of Revenues	0.0%	0.0%	3.8%					
Surplus as % of Expenditures	0.0%	0.0%	4.0%					

Appendix 4

Summary of Revenues, Expenditures and Surplus
Local Funds

FY 2011 LOCAL FUNDS								
					Actual vs. Revised		Actual vs. Original	
	Original	Revised	Actual		$	Percent	$	Percent
Taxes	$ 4,869.8	$ 5,054.2	$ 5,203.2		$ 149.0	2.9%	$ 333.4	6.8%
Non Taxes	463.1	400.3	429.2		29.0	7.2%	(33.9)	-7.3%
Fund balance release	34.9	36.0	42.2		6.2	17.3%	7.3	21.0%
All other GF Sources	258.1	246.9	141.4		(105.5)	-42.7%	(116.6)	-45.2%
	$ 5,625.9	$ 5,737.3	$ 5,816.0		$ 78.7	1.4%	$ 190.2	3.4%
Less Fund Balance release	**$ 5,591.0**	**$ 5,701.3**	**$ 5,773.8**		**$ 72.5**	**1.3%**	**$ 182.9**	**3.3%**
Expenditures:								
FY 2011 Advance to Public Education	$ 5,624.5	$ 5,609.9	$ 5,523.3		$ (86.7)	-1.5%	$ (101.3)	-1.8%
FY 2012 Advance to Public Education	-	126.6	126.6		-	0.0%	126.6	
Total Expenditures	$ 5,624.5	$ 5,736.5	$ 5,649.8		$ (86.7)	-1.5%	$ 25.3	0.4%
Revenues vs. Exp	**$ 1.3**	**$ 0.8**	**$ 166.2**		**165.4**		**164.9**	
Surplus as % of Revenues	0.0%	0.0%	2.9%					
Surplus as % of Expenditures	0.0%	0.0%	2.9%					

Appendix 5

	YELLOW BOOK FINDINGS FY 2001 - FY 2011	
	Material Weaknesses	**Reportable Conditions/Significant Deficiencies***
FY 2001	DCPS Accounting & Fin Reporting	Cash/Bank Reconciliation
	UDC Accounting & Fin Reporting	Human Resource/Payroll Process Mgmt
	Medicaid Provider Accounting	Accounting - Non-Routine Transactions
		Monitoring of Exp Against Open Procurements
		Disability Comp Claims Mgmt
		Reporting of Budgetary Revisions
FY 2002	Health Care Safety Net Contract Mgmt	Human Resource/Payroll Process Mgmt
	Medicaid Provider Accounting	Monitoring of Exp Against Open Procurements
		Disability Comp Claims Mgmt
FY 2003	Health Care Safety Net Contract Mgmt	Human Resource/Payroll Process Mgmt
	Medicaid Provider Accounting	Unemployment Comp Claimant File Mgmt
FY 2004	**NONE**	Unemployment Comp Claimant File Mgmt
		Management of Disability Comp Program
FY 2005	**NONE**	Management of Disability Comp Program
		Management of Unemployment Comp Trust Fund
FY 2006	District of Columbia Public Schools	Management of the Medicaid Program
FY 2007	Office of Tax and Revenue - Refund Process	Investment Reconciliations and Activities
	Management of the Medicaid Program	NCRC and the AWC
	District of Columbia Public Schools	Management of Grants
		Compensation
		Management of Disability Compensation Program
		Management of Unemployment Comp. Program
FY 2008	Treasury Functions	Compensation
	Management of the Medicaid Program	Office of Tax and Revenue
		District of Columbia Public Schools
		Management of the Postretirement Health and Life Insurance Trust
FY 2009	**NONE**	District of Columbia Public Schools
		Management of the Medicaid Program
		Office of Tax and Revenue
FY 2010	**NONE**	Information Technology
		Procurement and Disbursement
		Stand-alone reports:
		Unemployment Comp., UDC, WCSA, UMC, Office of Risk Management and Dept. Of Human Resources
		Office of Tax and Revenue
		Personnel Management and Compensation
FY 2011	**NONE**	Information Technology Controls
		Procurement and Disbursement Controls

* "Significant Deficiency" used starting FY 2007

	Material Weakness	**Reportable Condition/Significant Deficiency**
Medicaid	FY 2001, FY 2002, FY 2003, FY 2007, FY 2008	FY 2006, FY 2009
DCPS	FY 2001, FY 2006, FY 2007	FY 2008, FY 2009
Compensation		FY 2001, 2002, 2003, 2007, 2008, 2010